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ORIGINAL

1401 H Street NW
Suite 600
Washington DC
20005-2164

Tel (202) 326-7300
Fax (202) 326-7333
www.usta.org

EX PARTE

November 5, 1999

Magalie Roman Salas
Secretary
Federal Communications Commission
445-12th Street, SW
Room TW-A325
Washington, DC 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

RE: CC Docket No. 98-137 / ASD 98-91

Dear Ms. Salas:

On November 4, 1999, United States Telecom Association (USTA) representatives Kathleen Levitz, BellSouth Vice President of Federal Regulatory; Thomas Whittaker, Bell Atlantic Director of Capital Recovery; Anthony Alessi, SBC Director of Federal Relations; and Frank McKennedy, United States Telecom Association (USTA) Legal and Regulatory Affairs Director, met with FCC Common Carrier Bureau Staff Lisa Zaina, Kenneth Moran and Deena Shetler. The purpose of this meeting was to discuss why the Commission should grant USTA's Petition for Forbearance from Depreciation Regulation in the above-referenced proceeding. The attached material was presented and discussed.

In accordance with Section 1.1206(a)(1) of the Commission's rules, an original and six copies of this notice and the written material are being submitted to your office today. Please include this notice in the public record of these proceedings. Please contact me with any questions.

Respectfully submitted,

Frank McKennedy
Director-Legal & Regulatory Affairs

Attachment

cc w/o attachment: Lisa Zaina, FCC
Deena Shetler, FCC
Kenneth Moran, FCC

No. of Copies rec'd
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The United States Telephone Association Petition for Forbearance from Depreciation Regulation

**CC Docket No. 98-137
Filed 9/21/98
(ASD 98-91)**



The United States Telephone Association's Ex Parte: Forbearance from Depreciation Regulation

11/5/99



Relief from depreciation regulation

- **Now is the appropriate time to forbear from prescribing depreciation rates**
 - **The Telecommunications Act of 1996 permits forbearance and requires the elimination of unnecessary rules and regulations**
 - **Forbearance is in the public interest and eliminates unnecessary regulation**
 - **Fosters efficiency of Price Cap Carriers**
 - **Consistent with competitive market conditions and the recent Access Pricing Flexibility Order**

Relief from depreciation regulation

- **Current depreciation regulation is ineffective and unnecessary**
- **Price cap regulation works**
- **Competition works**
- **Many other alternative checks and balances to ILEC pricing**
- **Commission has established transition to total market based pricing and has provided for removal of competitive services from price caps**
- **Recovery of capital must be consistent with ILEC market environments**
- **Depreciation regulation is costly, burdensome and counter productive to the Commission's goals for market based pricing**
- **It is in the public interest to forbear from regulating depreciation**



With forbearance, ILECs will move toward GAAP for FCC reporting

- **Companies use forward-looking economic models (such as prepared by TFI) to set lives for externally reported depreciation in conformance with GAAP and these regulatory lives will match those externally reported lives.**
- **Rates used for external reports provide a more realistic pace of capital recovery, better matching consumption of resources in the competitive market environment.**



Consumer protection

- **Price cap regulation provides appropriate consumer protection.**
- **Purpose of Price caps is to emulate the restraint on prices experienced in a competitive market.**
- **Price Cap mechanism limits ILEC prices using a formula based on comprehensive economic market indicators, not changes in particular operating costs.**
- **Regulation of depreciation provides no effective consumer protections, is ineffective as a regulatory tool and should be forborne as it is unnecessary.**

Other safeguards

- **All charges shall be just and reasonable (section 201)**
- **FCC complaint process (section 208)**
- **FCC tariff review process**
- **SEC financial reporting**
- **External audit of financial reports**
- **Antitrust claims**



Forbearance does not affect the FCC's:

- **Authority to review Lower-Formula Adjustment filings**
- **Calculation of the Productivity Factor**
- **Determination of exogenous cost adjustments (depreciation changes are endogenous)**
- **Authority to review above-cap tariff filings**

Forbearance does not affect:

- **Prices for interconnection, UNEs or Universal Service support:**
 - **FCC's forward-looking economic cost model prescribes the capital recovery component for Universal Service support. The regulations from which forbearance is requested apply to the arbitrary determination of the rates of consumption of ILECs' total embedded assets**
 - **UNE prices and interconnection arrangements are developed by negotiation between parties or by the state PUC based on forward-looking, not recorded cost.**

FCC's Pricing Flexibility Order, Docket No. 96-262

Price Flex Order provides removal of services from price caps:

- **Immediate removal of IX services from price caps (conditional) - existing high degree of competition**
- **Provides frame work and triggers based on degrees of competition for additional pricing flexibility in MSAs**
 - **Phase I: Contract tariffs (remove from price cap)**
 - **Phase II: Removal of competitive services from price cap regulation**

FCC's Pricing Flexibility Order, Docket No. 96-262

- **“The Commission envisioned that this approach would enable it to give carriers progressively greater flexibility to set rates as competition develops, until competition gradually replaces regulation as the primary means of setting prices.” (¶ 2.)**
- **“Although our current price cap regime gives LECs some pricing flexibility and considerable incentives to operate efficiently, significant regulatory constraints remain. As the market becomes more competitive, such constraints become counter productive.” (¶ 19.)**
- **“...regulation imposes costs on carriers and the public, and the costs of delaying regulatory relief outweigh any costs associated with granting that relief before competitive alternatives have developed to the point that the incumbent lacks market power.” (¶ 90.)**

FCC's Pricing Flexibility Order, Docket No. 96-262

- **“First, existing rules clearly limit price cap LECs’ ability to respond to competition. Price cap LECs are subject to both our Part 61 rules regarding rate levels and the mandatory rate structure rules set forth in Part 69 of our rules. Our rules precluding LECs from offering contract tariffs and limiting volume and term discount offerings may create a price umbrella for competitors. Second, as mentioned above, delaying regulatory relief imposes costs on carriers and the public, the latter of which is deprived of the benefits of more vigorous competition.” (¶ 92.)**
- **“Finally, because regulation is not an exact science, we cannot time the grant of regulatory relief to coincide precisely with the advent of competitive alternatives for access to each individual end user. We conclude that the costs of delaying regulatory relief outweigh the potential costs of granting it before IXC’s have a competitive alternative for each and every end user.” (¶ 144.)**

Need to match responsibility for market pricing and depreciation

- **ILECs' increased freedom to price more responsively to competition must be matched by corresponding responsibility for capital recovery consistent with the competitive market environment**
- **Current depreciation regulation does not allow ILECs to reflect the effects of the market conditions in which they operate**
- **Forbearance from depreciation regulation would alleviate this mismatch**



Summary

- **The Commission should forbear from regulation of depreciation NOW.**
- **Forbearance is in the public interest and meets all the goals of the Act.**
- **Forbearance does not eliminate consumer protection.**
- **Forbearance does not affect the price cap mechanisms.**
- **Forbearance promotes efficiency and competition.**
- **Forbearance is consistent with and necessary to achieve efficient results from pricing flexibility.**

There are no real risks from forbearance

CC DOCKET NO. 98-137

PARAGRAPH 6

ABOVE-CAP FILING	<ul style="list-style-type: none">• Stringent cost showing already required under Commission rules.
“X” FACTOR	<ul style="list-style-type: none">• Does not vary with changes in depreciation rates.
UNIVERSAL SERVICE	<ul style="list-style-type: none">• The FCC’s forward-looking economic cost model prescribes the input for capital recovery, not Part 32:accounting rules nor ILEC accounting practices.
EXOGENOUS COSTS	<ul style="list-style-type: none">• Depreciation changes are endogenous.
UNE PRICES	<ul style="list-style-type: none">• Under Section 252, UNE prices may be negotiated between the parties or determined by the state PUC regardless of the ILEC depreciation practices.
TAKINGS	<ul style="list-style-type: none">• Beginning with implementation of forbearance, an ILEC becomes responsible for the effects of its own capital recovery policies absent regulatory interference.
LFAM	<ul style="list-style-type: none">• When used, an LFAM adjustment is subject to intense FCC scrutiny.• The LFAM is an exogenous adjustment effective for only one year. It is then reversed, returning the price cap to its lower, unadjusted level.
Note: In any event, the FCC retains authority and oversight in all of these matters, irrespective of the manner in which depreciation lives and rates are used for regulatory financial reporting purposes.	